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Applying Civil Penalties for Willful Violations of FBAR Requirements

Will the Fifth Circuit Clarify the IRS's Burden of Proof?

By Caroline Rule

District courts and other authorities disagree on whether the IRS must prove willfulness by a preponderance of the evidence or by clear and convincing evidence when seeking a civil penalty for willful failure to file a Report of Foreign Bank and Financial Accounts (FBAR). A pending appeal, *Gubser v. Comm'r* [No. 16-40948 (5th Cir.)], may ultimately lead to the first Federal Court of Appeals authority on the issue.

Civil FBAR-Related Penalties

Under 31 USC sections 5321(a)(5)(C)–(D), a civil penalty of the greater of $100,000 or 50% of the value of the undeclared foreign account at the time the FBAR was due, per year, applies to anyone who willfully violates any provision of 31 USC section 5314. In addition, 31 CFR section 1010.350(a), promulgated under 31 USC section 5314, requires annual FBAR filings by "each United States person having a financial interest in, or signature authority over, a bank, securities or other financial account in a foreign country," if the aggregate value of all such accounts in a year exceeds $10,000. The civil penalty for a non-willful failure to file an FBAR is $10,000 per year [under 31 USC section 5321(a)(5)(B)].

The authority to enforce the FBAR requirements and to assess and collect civil penalties is delegated to the Commissioner of Internal Revenue by 31 CFR section 1010.810(g). The statute of limitations on seeking civil penalties under 31 USC section 5321(a) is six years. Consequently, someone who, for six years, willfully failed to file FBARs reporting a foreign account with a consistent value of $2 million could owe a civil FBAR penalty of as much as $6 million, while the maximum penalty for a non-willful failure would only be $60,000. IRS Memorandum SBSE-04-0515-0025 (May 13, 2015), incorporated into the Internal Revenue Manual (IRM), states that, after May 12, 2015, even when failure to file FBARs is willful, in most cases the penalty will be a one-time 50% penalty of the highest balances of the foreign accounts for all years under examination. But the IRM further states that, "for violations occurring after October 22, 2004 … examiners may recommend a penalty for each year for which the FBAR violation was willful."

The IRM further states that "the test for willfulness is whether there was a voluntary, intentional violation of a known legal duty" and "the burden of establishing willfulness is on the Service" [sections 4.26.16.6.5.1(1) and (3) (Nov. 6, 2015)]. The IRM does not, however, define the standard of proof that the IRS must meet.

Varying Standards of Proof of Willfulness

IRS Office of Chief Counsel Memo (CCM) 200603026 (Jan. 20, 2006) states: "We expect that a court will find the burden in civil FBAR cases to be that of providing 'clear and convincing evidence [of willfulness],' rather than merely a 'preponderance of the evidence.'" This is the IRS's burden in civil tax fraud cases, which similarly involve proof of intent.

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The court in *U.S. v. Williams* [2010 WL 3473311 (E.D. Va. Sept. 1, 2010)], however, held without discussion that the government's "burden [is] to establish [a willful violation of 31 USC section 5314] by a preponderance of the evidence" in order to impose a civil FBAR penalty under 31 USC section 5321(a)(5)(C). In reversing on unrelated grounds, the Fourth Circuit did not mention the IRS's requisite standard of proof for willfulness. In *U.S. v. McBride* [908 F. Supp.2d 1186, 1201 (D. Utah 2012)], the court held: "The preponderance of the evidence applied by the district court in *Williams* is the correct standard." Furthermore, in *U.S. v. Zwerner* [No. 1:13-cv. 22082 (S.D. Fla., see unpublished order May 28, 2014)], the court submitted the willfulness issue to the jury on a preponderance of the evidence standard. Thus, the only three federal district courts to have addressed the standard of proof of willfulness when the IRS seeks to impose civil penalties for willful FBAR violations all applied the preponderance of the evidence standard.

Commentators, however, have relied on CCM 200603026 to aver that the clear and convincing evidence standard applies [e.g., Bryan C. Skarlatos and Michael Sardar, "Taxes and Penalties on Unreported Foreign Assets: Who Foots the Bill?" *Journal of the American Academy of Matrimonial Lawyers*, vol. 27, no. 1, http://bit.ly/2co0nmh], or have suggested that litigants should still argue for the clear and convincing standard: "The argument that the higher clear and convincing evidence standard should be used for … the FBAR [penalty] … is based on … jurisprudence that the higher standard of proof should apply where fraud-like allegations form the basis for the penalty … It is clear and uniformly held that the government must prove civil fraud to impose the tax civil fraud penalty [under IRC section 6663] by clear and convincing evidence," even though the text of IRC section 6663 does not specify this heightened standard of proof [Michael I. Saltzman and Leslie Book, *IRS Practice and Procedure*, Thomson Reuters, 2016].

The *Gubser* Case

Bernard Gubser, a Swiss citizen by birth and a naturalized U.S. citizen, opened a Swiss bank account when he was a young man to hold savings for his retirement in Switzerland. He openly held the account in his own name, and funds in the account consisted of after-tax compensation and inheritances. A CPA prepared Gubser's U.S. tax returns for over 20 years before someone in the CPA's office inquired in 2010 whether Gubser had an interest in a foreign financial account. This was the first time Gubser learned of his FBAR obligations, after which he timely filed an FBAR for 2009 and subsequent years. Gubser also entered the IRS offshore voluntary disclosure program (OVDP) for 2003 through 2010, but opted out of the OVDP penalty framework. The IRS then sent to Gubser Letter 3709, the "FBAR 30-Day Letter," proposing a 50% willful civil FBAR penalty for 2008 under 31 USC section 5321(a)(5)(C), which amounted to about $1.3 million, or *half of Gubser's entire lifetime savings*. The letter informed Gubser that he could protest the penalty with IRS Appeals, which he did. The appeals officer on the matter told Gubser that the IRS could prove willfulness by a preponderance of the evidence, but not by clear and convincing evidence, and asked for guidance regarding the proper standard of proof.

Gubser then sought a declaratory judgment in the District Court for the Southern District of Texas, asking the court to declare that the IRS must prove willfulness by clear and convincing evidence. The court, however, granted the government's motion to dismiss the complaint on standing grounds, holding that Gubser's injury could not be redressed by a declaratory judgment, which would not bind the IRS from assessing a penalty [*Gubser v. Comm'r*, 2016 WL 3129530 (S.D. Tex. May 4, 2016)].

On appeal, Gubser stated that "his controversy with the IRS turned on a single, purely legal question," that is, which standard of proof the IRS must meet to prove that he willfully failed to file his 2008 FBAR. He argued that a declaratory judgment plaintiff need not suffer an actual injury before seeking relief, that he satisfied his burden with respect to the first two elements of standing [i.e., 1) imminent harm 2) caused by the defendant's action to propose a willful FBAR penalty], and that a declaratory judgement plaintiff need not establish proximate causation, only that the injury is "fairly traceable to the defendant." Gubser also argued that he has established redressability, because he need only show that it is substantially likely that the parties will abide by the court's declaration of law; that he has demonstrated that the IRS Appeals officer on his matter is likely to apply the standard that the district court declares, since that officer specifically asked for guidance on this issue; and that a party may seek declaratory judgment even though the court's order does not mandate action by the parties and does not resolve all issues in the case.

An Anticipated Ruling

If the Fifth Circuit agrees that Gubser has standing and therefore remands the matter to the district court to issue a declaratory judgement, it is almost inevitable that either Gubser or the government will appeal to the Fifth Circuit the district court's declaration as to the appropriate standard of proof. Consequently, the Fifth Circuit may well become the first Federal Court of Appeals to rule on this important evidentiary issue regarding civil penalties for willful FBAR violations. Gubser filed his Fifth Circuit Brief on August 24, 2016, and amici curiae filed a brief in support of Gubser seven days later. As of press time, the government's brief was due on September 26, 2016. ❑

Caroline Rule, JD, *is a partner at Kostelanetz & Fink LLP, New York, N.Y.*